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In the Supreme Court of the United

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OCTOBER TERM, 1983

IAN T. ALLISON AND FRED K. AUSTIN, PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION

*ON PETITION FOR A WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS FOR
THE NINTH CIRCUIT*

**BRIEF FOR THE SECURITIES AND EXCHANGE
COMMISSION IN OPPOSITION**

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QUESTION PRESENTED

Whether the courts below properly held that petitioners had failed to raise an issue of material fact sufficient to defeat a motion for summary judgment regarding the SEC's claims that petitioners fraudulently manipulated the market for certain securities and that petitioners made material misrepresentations by failing to disclose various facts about their dealings in those same securities.

(I)

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OPINIONS BELOW

The unpublished opinion of the court of appeals (Pet. App. A25-A30) is reported at 722 F.2d 747 (table). The opinion of the district court (Pet. App. A1-A24) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on October 24, 1983. The petition for a writ of certiorari was filed on January 23, 1984. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. In December 1980, Pabagold, Inc., a Delaware corporation, was seeking capital to finance its plans to market a new suntan lotion (Pet. App. A3). With the assistance of Abe Weiner, a friend of petitioners, Pabagold's officers met

with Paulson Investment Company (Paulson), a broker-dealer (*ibid.*). Paulson agreed to underwrite a public offering of 700,000 shares and to act as market-maker after the initial distribution (*ibid.*; Sept. 15-16, 1981 Tr. 94-95). The offering was originally scheduled for March 1981 (Pet. App. A4).

Between January and March 1981, unknown to Paulson, petitioners, two businessmen with substantial foreign business connections, made arrangements to have various nominees place buy orders with Paulson for the entire distribution (Pet. App. A4-A6). Petitioners' initial attempt to purchase the entire offering was aborted, however, when Paulson, upon receiving the purchase orders before any circulars were distributed, suspended the offering pending an inquiry regarding the origins of the orders (*id.* at A6, A28).¹ Weiner represented to Paulson that the offers came from his foreign contacts; he concealed that petitioners had arranged all of the offers (*id.* at A28). Paulson accepted Weiner's representations and rescheduled the offering (*id.* at A6).

Paulson renewed the Pabagold offering in April 1981, but offered the stock in only three states in which the offering had been approved for sale by state securities commissions. Once again, unknown to Paulson, petitioners used a network of nominees to place purchase orders for the

¹The offering was made under Regulation A, a limited exemption from the registration otherwise required under the Securities Act of 1933 (Securities Act), 15 U.S.C. 77a *et seq.* 17 C.F.R. 230.251 *et seq.* Regulation A requires that an offeree receive an offering circular at or prior to the time an offer to sell is made. 17 C.F.R. 230.256(a)(1). Because Paulson received funds prior to distributing the offering circulars, it apparently concluded that someone must have made offers prior to dissemination of the circulars, and that the exemption from registration was therefore threatened (Pet. App. A6). See 17 C.F.R. 230.256(a)(2).

entire offering. Petitioners hired seven agents in the three states, each of whom was to purchase 100,000 shares in his own name, on behalf of one of seven foreign corporations controlled by petitioners (Pet. App. A6-A8). Petitioners failed to disclose to these individuals that they were hiring others to place similar orders to control the entire offering (*id.* at A19). Paulson executed the purchase orders in the names of the seven agents, thus placing the entire distribution under petitioners' control (*id.* at A8).

Prior to commencement of trading in the secondary market, petitioners touted the stock to other people without disclosing that they controlled all the shares to be sold in the market (Pet. App. A8-A9). Thus, when the market opened, Paulson received unsolicited offers to buy the stock from persons petitioners had contacted (*id.* at A9).² In response to the demand created for Pabagold securities, petitioners sold their shares into the market at steadily increasing prices. By the sixth day of trading, the price reached a high of \$1-5/8 bid and \$2 asked before Paulson voluntarily suspended trading (*id.* at A9-A10). In sum, during the six days of trading, petitioners sold 134,000 shares at an average of \$1 per share that they had purchased at 50 cents per share (Exh. 32).

2. Shortly after Paulson suspended trading, the Commission filed the instant suit against petitioners and others in the United States District Court for the District of Oregon seeking injunctive and other equitable relief (Pet. App. A2). The Commission alleged that petitioners' conduct violated, among other things, antifraud provisions of the Securities Act § 17(a), 15 U.S.C. 77q(a), and the

²For example, the day the market opened, four of petitioner Austin's friends immediately placed unsolicited orders for 10,000 shares with Paulson (Pet. App. A9; Exh. 32). During the first two days of trading, four individuals to whom petitioners touted Pabagold stock purchased over 70% of the stock traded (Pet. App. A9-A10; Exhs. 31,32).

Securities Exchange Act of 1934 (Securities Exchange Act) § 10(b), 15 U.S.C. 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. 240.10b-5.³

The Commission moved for summary judgment against all defendants (Pet. App. A2). In response, defendants filed an affidavit by their counsel in which they conceded many of the material facts listed in the Commission's statement of undisputed facts, but disputed certain items (Pet. App. A11). The court did not act on the Commission's motion for summary judgment at that time. The Commission renewed its motion after the evidentiary hearing on a preliminary injunction motion was completed. The court then held oral argument on the motions for a preliminary injunction and for summary judgment (Dec. 17, 1981 Tr. 16, 64). Petitioners never filed an opposing memorandum, affidavits or any other evidence in response to the renewed motion for summary judgment (Pet. App. A11-A12).

The district court granted the Commission's motion for summary judgment (Pet. App. A1-A24). The court concluded that petitioners secretly obtained control of the entire Pabagold offering and then manipulated the market by directing the sale of limited amounts of the stock while encouraging others to buy Pabagold stock, in violation of Section 17(a) of the Securities Act, 15 U.S.C. 77q(a), and Section 10(b) of the Securities Exchange Act, 15 U.S.C. 78j(b), and Rule 10b-5, 17 C.F.R. 240.10b-5 (Pet. App. A16-A17).⁴ The court concluded: "A better case of

³The district court entered an order temporarily restraining all of the defendants from violating antifraud provisions of the federal securities laws and freezing the proceeds from petitioners' sales of Pabagold stock (Pet. App. A2). The order was extended by consent to permit the parties to take discovery and otherwise prepare for an evidentiary hearing or the Commission's application for a preliminary injunction.

⁴The district court held that no genuine issues of material fact existed (Pet. App. A2). The court noted that, despite the explicit requirements of Fed. R. Civ. P. 56, petitioners had failed to support their claims of material factual disputes with supporting evidence (Pet. App. A11-A12).

manipulation is hard to imagine" (Pet. App. A16). The district court also found that petitioners knowingly misrepresented material facts, and omitted to state others, regarding the scheme, also in violation of antifraud provisions (Pet. App. A17-A19).⁵ Finally, the court rescinded the stock sales by ordering the stock petitioners had sold returned to them; enjoined the defendants from any further trading in Pabagold stock; and ordered them to disgorge the proceeds of their illegal sales (Pet. App. A37-A38).⁶

The court of appeals affirmed in all material respects (Pet. App. A25-A30). On the issue of petitioners' scienter in the manipulation scheme, the court found that the Commission "produced abundant evidence" that petitioners "went to great efforts" to conceal their control of the entire offering and to manipulate the market (Pet. App. A26-A27). The court found that petitioners' "bare denial, without evidentiary support" was insufficient to defeat a motion

⁵With respect to the Commission's charge that petitioners violated the registration provisions of the Securities Act, Section 5(a) and (c), 15 U.S.C. 77e(a) and (c), the district court denied the Commission's motion for summary judgment and granted defendants' motion to dismiss that part of the Commission's complaint (Pet. App. A20-A22). The Commission did not appeal that ruling.

⁶In addition to petitioners, Abe Weiner and seven foreign corporations controlled by petitioners (Pet. App. A14-A15 n.8) were enjoined from violating various antifraud provisions in connection with the manipulation of Pabagold stock (Pet. App. A32-A38). They have not sought review of the decision below by this Court.

The district court held that the seven foreign corporations were liable for petitioners' actions on alternative grounds. First, the court rested liability on the corporate powers granted petitioners to conduct the manipulative scheme in the names of these corporations (Pet. App. A14-A15 n.8). Second, the court rested liability on its finding, as a sanction under Fed. R. Civ. P. 37(b)(2)(A) and (d), that these corporations were petitioners' nominees or alter egos (Pet. App. A14-A15 n.8). The sanction was imposed for "defendants' willful failure to cooperate with the SEC's discovery efforts to determine the truth of this very fact" (*ibid.*).

for summary judgment under Rule 56(e) (Pet. App. A27-A28). Similarly, the court found petitioners' challenge to the findings of material misrepresentations and omissions to be without merit, as "[t]here was no evidentiary submission by [petitioners] to contest this matter" (Pet. App. A28).

ARGUMENT

1. Petitioners argue (Pet. 8-15) that summary judgment on the manipulation count was inappropriate because there was a genuine issue of material fact regarding scienter.⁷ This factbound issue, which was correctly decided below, does not warrant review by this Court. Despite the uncontested evidence introduced by the Commission, which the district court found to be "abundant," petitioners chose to rest on their "conclusory allegations" and "bare denials" on the issue of scienter (Pet. App. A11-A12, A27). Where scienter is an issue, summary judgment may properly be granted "[i]n the absence of 'any significant probative evidence tending to support' " the opposing party's contention. *Betaseed, Inc. v. U & I, Inc.*, 681 F.2d 1203, 1207 (9th Cir. 1982) quoting *First National Bank v. Cities Service Co.*, 391 U.S. 253, 290 (1968)). The courts below were clearly correct in holding that petitioners had failed to satisfy their burden under Rule 56, to demonstrate the existence of a triable factual issue.⁸

⁷Scienter is an element of a violation of Section 17(a)(1) of the Securities Act, 15 U.S.C. 77q(a)(1) and Section 10(b) of the Securities Exchange Act; it is not an element of a violation of Section 17(a)(2) and (3) of the Securities Act, 15 U.S.C. 77q(a)(2) and (3). *Aaron v. SEC*, 446 U.S. 680, 697 (1980); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 (1976). Thus, the findings of petitioners' violations of Section 17(a)(2) and (3) would stand even if the Commission had not established scienter as to their other antifraud violations.

⁸Petitioners also claim (Pet. 7, 16) that the Commission did not prove they had a financial interest in the sales of Pabagold stock. On the contrary, the district court found the foreign corporations in whose names the shares were purchased to be petitioners' nominees or alter egos (Pet. App. A15 n.8); the court of appeals affirmed that determination (*id.* at n.2).

2. Petitioners also argue (Pet. 11-15) that summary judgment should not have been entered on the issue of whether they had a duty to disclose material facts.⁹ This contention has no merit.

The district court properly found that petitioners had an affirmative duty to disclose material facts since petitioners shared a "relationship of trust and confidence" with the agents they used for the purchases, those individuals to whom they recommended the stock and Paulson (Pet. App. A19). Petitioners' duty to disclose also arose as a matter of law from their role—by virtue of their control of the entire offering—as participant underwriters (Pet. App. A20-A22). See *SEC v. Murphy*, 626 F.2d 633, 648-652 (9th Cir. 1980).¹⁰ Thus, they had a duty to disclose all material facts in the offering circular and an additional duty to disclose to Paulson, their co-underwriter.¹¹ Accordingly, petitioners

⁹Petitioners' undisputed knowledge of the "underlying facts" that were not disclosed establishes their scienter on this issue as a matter of law. "Failure to disclose that market prices are being artificially [manipulated] * * * is an omission of a material fact." *United States v. Charnay*, 537 F.2d 341, 351 (9th Cir. 1976).

¹⁰Petitioners argue (Pet. 11-12) that the Commission must show reliance upon, and damages from, their misrepresentations. Though reliance and damages may be relevant in a private action, they are not elements in a Commission action for injunctive relief. See *Aaron v. SEC*, 446 U.S. 680, 700-702 (1980); cf. *Hanly v. SEC*, 415 F.2d 589, 596 n.9 (2d Cir. 1969) (Section 17(a) of the Securities Act) (administrative disciplinary proceeding).

¹¹Petitioners assert (Pet. 15) that they were denied due process because the district court misled them into believing it would not decide the Commission's motion for summary judgment, but then granted the motion, thereby depriving them of an opportunity to introduce favorable evidence. This assertion is contradicted by the record. The Commission originally moved for summary judgment in August 1981 and renewed its motion on October 12, 1981; the court set oral argument on that motion, as well as on the preliminary injunction motion, for December 17. Between October 12 and December 17, petitioners filed no opposition to the summary judgment motion (Pet. App. A11-A12). During the oral argument, the court gave petitioners an additional

raised no question of fact regarding their breach of the duty to disclose their manipulations; further review by this Court is therefore not warranted.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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opportunity to bring disputed facts to its attention; petitioners failed to do so (Pet. App. A12 n.5). Moreover, after oral argument, petitioners made no attempt to bring any factual disputes they believed existed to the attention of the court before it filed its opinion (Pet. App. A24). Petitioners cannot now complain that they were deprived of the opportunity to submit evidence to oppose summary judgment.